CONSUMER COUNSEL TESTIMONY
Opposing SB 276
By BOB NELSON, Consumer Counsel (444-2771)
February 19, 2013

Chairman Olson and Committee Members,

Introduction

Consumer Counsel pursues two general objectives on behalf of ratepayers: 1) safe, reliable and adequate service, 2) at just and reasonable rates. We certainly understand and support, therefore, the impetus behind SB 276. It is well intended to ensure safe and reliable service. However, it is likely do so at the unnecessary expense of the second objective of just and reasonable rates.

Current Regulation

Public utilities are monopolies providing essential services. They are thus regulated for consumer protection, and in an attempt to emulate economic efficiency that a competitive market would encourage. Regulators set rates based on a snapshot in time. This is based on what is known as the "matching principle" or "test period" where all expenses, revenues and investment related to each other from the same time frame are captured and considered in setting rates. The test period rule ensures fairness. Utilities might like to include post-test period expenses and investment to increase the apparent need for revenue (higher rates), while consumers might like to include post-test period revenues or expense reductions to reduce the revenue requirement. Test period disputes are not uncommon. With few exceptions, the Commission adheres to setting rates based strictly on information from the test period.

SB 276

There are several concerns with SB 276.

- First, it violates the test period matching principle. It allows for consideration of cost increases, without considering cost decreases. To its credit, the Bill recognizes the problem and attempts to address it in Section 3(6) by excluding investments that would increase utility revenue by connecting to new customers. This partial adjustment, however, does not take into account reduced O&M expenses with newer facilities, and does not address the fact that many other items – other revenues, expenses, volumes and cost of capital – have almost certainly changed since the last rate case. There is simply no way to know what a reasonable revenue

requirement would be without a full and balanced review. This Bill would limit such a review by removing certain distribution infrastructure from general rate cases.

There are exceptions to the test period rule where certain expense items are "tracked." The most significant of these are the longstanding commodity trackers for recovery of gas and electricity commodity costs. There are three historical requirements for these acknowledged exceptions, however: the expense is very large (up to half the total revenue requirement), very volatile (experiencing large swings), and beyond the utility's control (market driven). Other exceptions concern Universal System Benefits Charges (USB) and state property taxes; both of these are state-mandated.

- Second, the Bill weakens an important efficiency incentive inherent in current regulation. Public utilities have a legal obligation to provide adequate, safe and reliable service. Without immediate one-sided cost recovery, the utility has an incentive to meet this requirement in the most efficient manner possible. This incentive is thought to best reside with those who can control the cost – that is, the utility. With the cost recovery mechanism envisioned in this Bill, there is more of an incentive to invest and earn the authorized rate of return intended to reflect normal business risks, while actually taking on much less risk. If there were reason to believe that sufficient distribution investment weren't occurring, these tradeoffs might make more sense. There is no such evidence.

  SB 276 will create incentives, but these incentives may be largely accounting incentives that will be difficult to monitor. Since Section 3(6) defines eligible investments as those not included in a utility's base rate, the utility will stand to gain by classifying the greatest amount of distribution investment as above and beyond "business as usual." This will become an intricate accounting issue and, ultimately, will require an arbitrary assignment.

- Finally, this Bill amounts to preapproval of certain distribution system investments. Preapproval shifts risks of the investment from the utility to its customers, unlike a competitive business which regulation is generally supposed to emulate. Utilities in Montana have been recently allowed to request preapproval for generation facilities, but that was based on the belief that financing for such large projects would not otherwise be available from third parties. That circumstance does not justify a similar exception for distribution system improvements. A related more minor, but practical, concern is that the Bill shifts the burden of proving the reasonableness of these charges from the utility to the Consumer Counsel. The necessary information is not in our custody, and routinely developing such cases could present an increased work load.

Distribution system improvements are important, but can be addressed by the Public Service Commission within the current regulatory framework. There is no need to create an

extraordinary recovery mechanism that violates the matching principle, dampens important efficiency incentives, engages in risk-shifting to consumers, and threatens unnecessary cost increases which will ultimately be borne by Montana ratepayers.

Thank you for considering these comments.

The National Association of State Utility Consumer Advocates
Resolution 2005-03

INFRASTRUCTURE SURCHARGE RESOLUTION

Calling upon state regulatory authorities and legislatures to refuse to allow, or to consider revoking, annual tracking adjustments to rates resulting from additional non-traditional gas, water, sewer or electric infrastructure replacement programs;

Whereas, traditional ratemaking methodologies have allowed investor shareholders to earn a return on new and upgraded mains and electric plant through general rate case reviews allowing the ratepayers being charged for the prudent and necessary system upgrades to be represented in traditional contested rate proceedings in which all items of expense and capital investments are considered; and

Whereas, depreciation provides a "funding" mechanism for natural gas, water, sewer, and electric plant replacement because it reduces net operating income and increases the revenue required from rate payers for an acceptable rate of return during the formal rate proceeding; and

Whereas, traditional ratemaking processes have withstood the test of time, so that all parties represented have an opportunity to have their interests fairly represented; and

Whereas, parties representing the interests of shareholders and company managements may propose "short-circuit" methods focused on single categories of increased expense, in order to "speed up" the recovery of costs outside the normal regulatory process, and to provide regulators ways to avoid the rate review process; and

Whereas, utilities in several states have proposed, either in rate cases or as state legislation, various "tracking methodologies" which, if allowed, would enable them to increase rates through non-traditional ratemaking processes sometimes called DSIC (Distribution System Improvement Charge), DSR (Distribution System Replacement), AMRP (Accelerated Main Replacement Program) PRP (Pipeline Replacement Program) which would allow immediate rate recovery of capital investment for new projects on a year-by-year basis in order to replace certain rate base infrastructure through a surcharge; and

Whereas, if such tracking methodologies were allowed, regulatory authorities may not be able to review such capital investments for prudence, and may not be able to review possible offsetting contemporaneous cost reductions or revenue increases from other utility activities; and

Whereas, if such tracking methodologies are allowed ratepayers will become involuntary investors paying for unreviewed investments that will increase rates;

Whereas, at a time of rising commodity costs, regulators need to understand the potential significant new burden upon consumers caused by a tracking surcharge for plant additions;

THEREFORE BE IT RESOLVED, that NASUCA calls upon state regulatory authorities and legislators to refuse to impose on consumers, or to consider revoking, non-traditional infrastructure surcharges that would increase natural gas, water, sewer or electric utility bills without traditional opportunity for consideration of countervailing cost decreases and revenue increases, and review by all parties including appropriate consumer advocacy offices prior to implementation and to remain committed to traditional ratemaking principles fairly representing the interests of both consumers and stockholders.

BE IT FURTHER RESOLVED, that NASUCA authorizes its Standing Committees to develop specific positions and to take appropriate actions consistent with the terms of this resolution to secure its implementation, with the approval of the Executive Committee of NASUCA. The Standing Committees or the Executive Committee shall notify the membership of any action taken pursuant to this resolution.

Submitted by:

Michael D. Chrysler, Chair, Consumer Protection Committee
June 12, 2005

Approved by NASUCA

Place: New Orleans, LA
Date: June 14, 2005

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